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CASE NO. _____

IN THE UNITED STATES SUPREME COURT
OCTOBER TERM, 1991

UNITED MISSIONARY AVIATION, INC.
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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72

QUESTIONS PRESENTED

1. Whether the radical departure from existing law introduced by the present decision creates an irreconcilable conflict of the Federal Circuits on the definition of a religious, charitable or educational "purpose" under 26 U.S.C. 501(c)(3) which must be resolved by this Court.

2. Is the Eighth Circuit's unconstitutional amendment of the Internal Revenue Code, adding a new, third requirement for qualification under 501(c)(3), contrary to both the express language of the Code and its long-standing legislative history and purpose?

3. Can this Court permit the *rationale* of the present case to become part of the federal tax law without subjecting the tax-exempt status of an incalculable number of religious, charitable and educational organizations to arbitrary revocation by the Commissioner, unhindered by any preexisting and ascertainable criteria?

4. Whether the Commissioner abused his discretion under 26 U.S.C. 7805(b) by failing to limit the retroactive effect of his revocation of exemption under 26 U.S.C. 501(c)(3).

PARTIES TO THE PROCEEDING

Pursuant to S. Ct. R. 14.1(b), following is a list of all parties to the proceedings before the United States Court of Appeals for the Eighth Circuit:

United Missionary Aviation, Inc., Appellant

Commissioner of Internal Revenue, Appellee

Pursuant to S. Ct. R. 29.1, the Petitioner hereby states that there are no parent companies nor non-wholly owned subsidiary companies of the Petitioner.

TABLE OF CONTENTS

QUESTIONS PRESENTED i

PARTIES TO THE PROCEEDING ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES iv

OPINIONS BELOW 1

JURISDICTION 1

STATUTES AND REGULATIONS INVOLVED 2

STATEMENT OF THE CASE 3

Facts of the Case 3
History of the Case 7

REASONS FOR GRANTING CERTIORI 8

I. THE EIGHTH CIRCUIT'S HOLDING THAT COMMERCIAL ACTIVITY, WITHOUT MORE, BY AN OTHERWISE TAX-EXEMPT RELIGIOUS, CHARITABLE OR EDUCATIONAL ORGANIZATION SOMEHOW CONSTITUTES AN IMPROPER "PURPOSE" IN AND OF ITSELF, VIOLATES FEDERAL LAW, AMOUNTS TO A JUDICIAL AMENDMENT TO 26 U.S.C. 501(c)(3) AND SHOULD BE SETTLED BY THIS COURT. 8

II. THE EIGHTH CIRCUIT'S HOLDING THAT COMMERCIAL ACTIVITY, WITHOUT MORE, CONSTITUTES A "PURPOSE" IN AND OF ITSELF, DIRECTLY CONFLICTS WITH A DECISION IN THE COURT OF APPEALS FOR THE THIRD CIRCUIT. 20

III. IF LEFT UNCHECKED BY THIS COURT, THE EIGHTH CIRCUIT'S HOLDING CALLS INTO QUESTION THE TAX-EXEMPT STATUS OF A LARGE PROPORTION OF THE RELIGIOUS, EDUCATIONAL AND CHARITABLE ORGANIZATIONS IN THE UNITED STATES AND WILL CHILL THEIR ACTIVITIES. 33

IV. THE COMMISSIONER ABUSED HIS DISCRETION UNDER CODE 7805(b) BY FAILING TO LIMIT THE RETROACTIVE EFFECT OF HIS REVOCATION OF EXEMPTION UNDER CODE 501(c)(3). 33

CONCLUSION 38

CASES

Automobile Club of Michigan v. Comm'r, 353 U.S. 180 (1957).....37

Better Business Bureau v. United States, 326 U.S. 279 (1945) 12, 25

Bob Jones Univ. v. United States, 461 U.S. 571 (1983).....13, 20, 22

Bose Corp. v. Consumers Union, 466 U.S. 485, 104 S.Ct. 1949 (1984) 13

Fides Publishers Ass'n. v. United States, 263 F.Supp. 924 (N.D.Ind. 1967) 12

Helvering v. Bliss, 293 U.S. 144 (1934).....23

Janaluska Assembly Housing, Inc. v. Commissioner, 86 T.C. 1114 (1986).....8

Lanson's, Inc. v. Comm'r, 622 F.2d 774 (5th Cir. 1980) 33, 37

Northern California Central Serv. v. United States, 591 F.2d 620 (Ct. Cl. 1979) 13

Presbyterian & Reformed Publishing Co. v. Commissioner, 743 F.2d 148 (3d Cir. 1984), revg. 79 T.C. 1070 (1982).....9, 11, 12, 13, 14, 15, 17, 18, 33

Pulpit Resources v. Comm'r, 70 T.C. 594 (1978).....18

Trinidad v. Sagrada Orden, 263 U.S. 578, 581 (1924).....22

United States v. Church of Scientology of Boston, Inc., 739 F.Supp. 46 (D. Mass. 1990).....34, 35, 37

United States v. Pleasants, 305 U.S. 357 (1939) 23

Walz v. Tax Comm'n of the City of New York, 397 U.S. 664 (1970) 22

STATUTES AND REGULATIONS

26 U.S.C. 501(c)(3) 2, 4, 9, 10, 11, 17, 18, 19, 20, 21, 24, 28, 29, 30, 31, 36

26 U.S.C. 511 21

26 U.S.C. 7805(b) 2, 33

26 U.S.C. 7428 7

28 U.S.C. 1254(1) 2

26 C.F.R. 1.501(c)(3)-1(c)(1) 7

26 C.F.R. 1.501(c)(3)-1(d)(1)(ii) 21

26 C.F.R. 1.501(c)(3)-1(d)(1)(iii) 21

26 C.F.R. 1.501(c)(3)-1(d)(2) 21

26 C.F.R. 1.501(c)(3)-1(d)(3)(i)(b) 21

26 C.F.R. 1.501(c)(3)-1(d)(3)(ii), Example (3) 22

26 C.F.R. 1.501(c)(3)-1(e) 21

26 C.F.R. 601.201(l)(5) 33, 37

26 C.F.R. 601.201(n)(6)(i) 34

OTHER

44 Cong.Rec., pt. 4, at 4151 (1909) 20, 24

Brown, *Religious Nonprofits and the Commercial Manner Test*, 99 Yale Law J. 1631 (1990) 23

U.S. News and World Report, April 13, 1992 (p. 60) 31

26 U.S.C. 513 26
26 U.S.C. 7428 9
26 U.S.C. 7805 2
26 U.S.C. 501(c)(3) 4, 9-11, 13, 14, 18, 21-26, 33-35
26 U.S.C. 7805(b) 20, 35
26 U.S.C. 511 11
28 U.S.C. 1254(1) 2
Section 501(c)(3) 22-24, 26
Section 6104(c) 22
26 C.F.R. sec. 601.201(n)(6)(i) (1990); emphasis added 21
26 C.F.R. 1.501(a)-1 24
26 C.F.R. 1.501(c)(3)-1(b) and (c) 13
26 C.F.R. 1.501(c)(3)-1(c)(1) 13
26 C.F.R. 1.501(c)(3)-1(d)(2) 12
26 C.F.R. 1.501(c)(3)-1(e) 11
26 C.F.R. 1.501(d)-1 26
26 C.F.R. 501(c)(3)-1 24
26 C.F.R. 601.201(l)(5 ..... 26, 36, 39
26 C.F.R. 601.201(n)(6)(i) 20, 36
26 C.F.R. 1.501(c)(3)-1(d)(1)(ii) 11
26 C.F.R. 1.501(c)(3)-1(d)(1)(iii) 11
26 C.F.R. 1.501(c)(3)-1(d)(3)(i)(b) 12
26 C.F.R. 1.501(c)(3)-1(d)(3)(ii), Example (3) 12

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioner, United Missionary Aviation, Inc., respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit, entered in the above-entitled proceeding on October 7, 1991.

OPINIONS BELOW

Pursuant to S. Ct. R. 14.1(d), following is a list of the official and unofficial reports of opinions delivered in this case by other courts or administrative agencies:

United Missionary Aviation, Inc. v. Commissioner,
60 TCM 1152, Dec. 46,957 (M), TC Memo 1990-566.

JURISDICTION

On October 7, 1991, the United States Court of Appeals for the Eighth Circuit rendered its decision affirming the Memorandum Decision of the United States Tax Court. On December 17, 1991, the Eighth Circuit

Court denied this Petitioner's petition for rehearing.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

This case involves 26 U.S.C. 501(c)(3) and 26 U.S.C. 7805(b) reprinted below.

26 U.S.C. 501

Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation .— An organization described in subsection (c) or (d) or 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under Section 502 or 503.

* * *

(c) List of exempt organizations.— The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earning of which inures to the benefit of any private shareholder or individual, no substantial part of the activities ofwhich is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

* * *

26 U.S.C. 7805

* * *

(b) Retroactivity of regulations or rulings.— The Secretary may

prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

* * *

Other statutes and regulations involved are reprinted in pertinent part in Appendix A. They include 26 C.F.R. 1.501(c)(3)-1(c), (d) and (e) (App. A, infra, p. 24a) and 26 C.F.R. 601.201(l)(5) and (n)(6) (App. A, infra, p. 26a).

STATEMENT OF THE CASE

Facts of the Case

The audio tape cassette was introduced in the mid-1960's (Tr., p. 8). Prior to the incorporation of the Petitioner, United Missionary Aviation, Inc. (hereinafter referred to as "UMA"), UMA's founder and executive director, Mr. Jay Cole (an ordained Southern Baptist minister), began experimenting with the idea of reproducing and distributing cassette recordings of Christian messages (Tr., pp. 4, 8). He believed this then-fledgling technology could provide the Christian church with an effective and economical means to evangelize the world and teach Christian doctrine. The primary purpose of these activities was to build the Christian church by: (1) evangelizing non-Christians through cassette tapes; (2) better equipping and training Christian missionaries to perform their evangelical and discipling activities; and (3) establishing and supporting churches for new and existing Christian bodies.

UMA was formed as an outgrowth of Mr. Cole's activities and had the same primary purpose (Tr., p. 7). UMA was incorporated on January 23, 1968 as a Texas non-profit corporation (Admin. Rec., Exh. 1-A, p.10).

UMA's Articles of Incorporation stated, *inter alia*, that its purposes were to:

> (a) *Supply air transportation* for missionaries and [C]hristian workers in furthering the spread of the Gospel of Jesus Christ.
>
> (b) Evangelize lost sinners *using any and all legitimate means in order to make known the Gospel and win souls to Christ.*
>
> (c) *Establish and edify local churches* according to the New Testament pattern.
>
> (d) [To] [a]ccomplish this two fold purpose, we will engage in *all forms of missionary service* including the sending, maintenance and support of missionaries at home and in foreign countries; sending gospel teams to conduct evangelistic, literature and visitation crusades; *writing, printing and distribution of Christian literature;* Bible Conferences, *specialized forms of missionary work* such as aviation evangelism, medical centers, photography, *radio and television;* the building of missions, chapels and churches; and *other forms of missionary service as the Lord may lead.*"

(Admin. Rec., Exh. 1-A, p. 11 (Emphasis added)).

UMA applied for and received recognition from the Commissioner of its tax-exempt status under 26 U.S.C. 501(c)(3) on September 30, 1968 (Admin. Rec., Exh. 2-B).

From its inception, UMA provided air transportation for missionary personnel, using an airplane which had been donated to UMA by Mr. Cole (Tr., p. 27). UMA also continued to develop and promote the establishment of Christian cassette tape libraries (Tr., pp. 8-10, 12-17, 53-55) and was active in establishing and supporting local churches (Tr., pp. 17-20).

Because of financial and time constraints, Christian organizations began to recognize the value of pre-recorded cassette tapes as a substitute means of carrying the Christian message to the world (Admin. Rec., Exh.

36-AJ and Exh. 38-AL). Pre-recorded cassette tapes proved to be ideal substitutes for missionaries and local preachers in certain applications. They were inexpensive (given the right sources), easy to transport and, best of all, their message was always powerful and consistent. UMA was at the forefront of this movement due to the foresight and expertise of Mr. Cole.

It naturally followed that Christian organizations wanting to establish cassette tape libraries of their own turned to UMA for technical assistance and advice (Letters from Christian organizations, Admin. Rec., Exh. 36-AJ and Exh. 38-AL; Tr., p. 13). UMA assisted Christian organizations by maintaining its own library of Christian messages from which it provided free "master tapes". UMA would then make available for sale blank tapes in bulk and the equipment with which the organization could produce as many of its own copies as it needed for distribution. UMA provided these materials at *wholesale* cost to active "Christian workers" (Admin. Rec., Exh. 34-AH, p. 2 and Exh. 41-AO, p. 2) and for other buyers it priced the materials at anywhere from five to twenty percent over its distributor cost — a price substantially *below* the suggested minimum retail cost ("discount house" or "mail order" cost) (Tr., p. 12; Admin. Rec., Exh. 39-AU).

This combination of events led to a dramatic expansion of UMA's cassette tape library activities and, to avoid confusion with its reduced, but on-going, aviation activities, UMA began conducting its cassette tape and equipment activities through what it called its "Missionary Tape and Equipment Supply" division (Tr., pp. 25-26, 54).

UMA was forced to mark-up the prices of the items it sold to Christian organizations, even though it sold at wholesale, in order to defray its expected overhead costs and to provide financial resources for its continued operations (Tr., pp. 12, 16). UMA did not mark up these items for the *purpose* of making a profit (Tr., p. 22). Substantial amounts of tapes and equipment were also given away to those who could not afford to pay for them (Tr., p. 89).

Although the demand for UMA's assistance rapidly grew, UMA's primary purpose of Christian evangelism never changed. Primarily through the encouragement and ingenuity of UMA, literally hundreds of Christian tape lending libraries were started throughout the world (Tr., p. 9)[1] Most of those libraries would not exist today but for UMA's assistance in providing low-cost tapes and equipment and UMA's practical and technical expertise (Admin. Rec., Exh. 36-AJ and Exh. 38-AL).

UMA was forced, however, to employ some techniques also used by commercial enterprises, such as catalogs, volume/discount purchasing, purchasing on credit, hiring employees, and the like. All of Mr. and Mrs. Cole's services, most of the managerial services, and a large part of the clerical services were provided to UMA free of charge by volunteers (Tr., pp. 5, 12, 48, 52-53, 85; Admin. Rec., Exh. 23-W, p. 6 and Exh. 37-

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[1]For example, UMA was instrumental in starting the cassette tape lending libarary of Bible Believers Cassettes of Springdale, Arkansas — the largest Christian cassette tape lending library in the world.

AK). The catalogs distributed by UMA are literally blanketed with quotations from the Bible and statements of its Christian purpose (Admin. Rec., Exh. 34-AH and Exh. 41-AO).

UMA was regularly in contact with senior members of the Commissioner's exempt organizations staff in Dallas, Texas. During those conversations, UMA described its operations and received assurances that its activities did not jeopardize its tax-exempt status (Admin. Rec., Exh. 23-W, p. 15). After UMA reported operating gains for 1973 and 1974, the Commissioner decided to audit UMA.

History of the Case

On August 28, 1980, the Commissioner decided to revoke UMA's exempt status effective for years beginning after December 31, 1973. The *sole ground* given for the retroactive revocation of UMA's exempt status was that "in operating a mail order sales business as your primary *activity* you were not operated exclusively for exempt *purposes* as required by Code Section 501(c)(3)" (App. A, p. 22a (Emphasis added); *See also*, Tr., p. 122; Cf., Tr., p. 123).

Pursuant to 26 U.S.C. 7428, UMA petitioned the United States Tax Court for relief from the Commissioner's determination. Despite the

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[2]The Commissioner has, therefore, effectively conceded that UMA satisfies the so-called "organization" test and the Tax Court so held. Further, failure of the Commissioner to rely on private inurement as ground for revocation of UMA's exemption, forecloses that avenue to him on appeal. Satisfication of the so-called "operational test" found in Reg. § 1.501 (c)(3)-1(c)(1) remains the primary question of law and fact.

uncontroverted testimony of Mr. Cole and an abundance of documentary evidence, Judge Körner ruled in favor of the Commissioner. The Tax Court correctly noted that the "focus is on the *purpose toward which an activity is directed, rather than the nature of the activity itself*" and "[c]onsequently, 'Even if petitioner's activities would normally constitute a *trade or business*, petitioner will not be disqualified so long as its activities *further* an exempt *purpose*.'" quoting from *Janaluska Assembly Housing, Inc. v. Commissioner*, 86 T.C. 1114, 1121 (1986) (App. A, p. 14a (Emphasis added)).

The Tax Court then inexplicably applied reasoning diametrically opposed to the very legal tests it had just recited and diverted its analysis from an examination of UMA's *purpose* to an examination of UMA's *activities* and held that UMA "possessed a nonexempt commercial purpose that was substantial in nature" (App. A, p. 15a).

UMA appealed that decision to the United States Court of Appeals for the Eighth Circuit, and that court affirmed the decision of the Tax Court, finding no error (App. A, p. 1a).

REASONS FOR GRANTING CERTIORI

I. THE EIGHTH CIRCUIT'S HOLDING THAT COMMERCIAL ACTIVITY, WITHOUT MORE, CONSTITUTES A NON-EXEMPT "PURPOSE" IN AND OF ITSELF, DIRECTLY AND IRRECONCILABLY CONFLICTS WITH A DECISION IN THE COURT OF APPEALS FOR THE THIRD CIRCUIT.

The two simple requirements for qualification for tax exempt status

under 26 U.S.C. 501(c)(3) at issue in the present case focus on the organization's purpose and net earnings:

1. The purpose of the organization must come within theaccepted areas of religion, charity or education; and
2. The net earnings of the organization may not inure to any private individual or shareholder.

Neither the law itself nor its legislative history prohibits the earning of profits from commercial activity. On the contrary, both the law's recognition of ***net*** earnings, and the legislature's acknowledgement of profits, *anticipate* activities within recognized tax-exempt purposes that may well produce earnings which *could* be diverted to private inurement.

This obvious reality in the world of religious, charitable or educational organizations, articulated with approval by the Third Circuit nearly ten years ago, has been the Federal *judicial* position, and thus the law of the land, until the rendering of the present decision. Indeed, in *Presbyterian and Reformed Publishing Co. v. Commissioner,* 743 F.2d 148 (3d Cir. 1984), the Third Circuit expressly rejected the Commissioner's attempt to adulterate the long-standing and judicially accepted definition of tax-exempt purpose when he argued that a qualified organization cannot be profitable and remain tax exempt.

Rejecting the Commissioner's confused rationale that "commercial activity" and net earnings are tantamount to a non-exempt purpose, the Third Circuit there held that the profitable activities of a

religious publishing company did not, *per se*, amount to its motivation by a non-exempt purpose under 501(c)(3).

The Presbyterian and Reformed Publishing Company (hereinafter referred to "P & R") was formed in 1931 to "... state, defend and disseminate (through every proper means connected with or incidental to the printing and publishing business) the system of belief and practice taught in the Bible ...".

The Commissioner granted P & R exempt status in 1939 and recognized that P & R's "income is derived from subscriptions, contributions and gifts and is used to defray maintenance and general operating expenses." P & R's founder and most of its directors were closely affiliated with the Orthodox Presbyterian Church. Samuel, Charles and Bryce Craig, all ministers, operated the publishing house for three generations from their kitchen table.

From its inception until 1969, P & R barely covered its operating expenses. In fact, the Craigs often had to contribute their personal funds to maintain P & R's finances. Until 1973, P & R relied exclusively on volunteers for assistance.

Beginning in 1969, P & R began to experience "a considerable increase in economic activity" and began reporting substantial gross profits. P & R began hiring paid employees to assist in its work. By 1979, P & R had accumulated *cash* in excess of $263,000.

In 1980, IRS sought to revoke P & R's exempt status on the ground

that P & R was not "operating exclusively for purposes set forth in 501(c)(3)" and was "engaged in a *business activity* which is carried on similar to a *commercial* enterprise." (Emphasis added.) The Commissioner made the revocation retroactive, to apply from January 1, 1969 onward.

The Third Circuit Court reviewed the reasoning and factors considered by the Tax Court and summarized them by saying that the Tax Court affirmed the Commissioner by "looking at the composite effects of the broad-scale increase in commercial activity, the accumulation of capital, the company's 'profitability,' and the development of a professional staff." *Presbyterian and Reformed Publishing Co. v. Commissioner,* 743 F.2d 148, 152 (3d Cir. 1984).

Rejecting these factors as determinants of qualification for tax-exempt status, the court stated:

> "It is doubtful that any small-scale exempt operation could *ever* increase its economic activity without forfeiting tax-exempt status under such a definition of non-exempt commercial character. Thus, we believe that the statutory inclusion or exclusion of P & R should be considered under a two-prong test: first, *what is the purpose* of an organization claiming tax-exempt status; and, second, *to whose benefit* does its activity inure?"

Presbyterian, id. at 152 (Emphasis added).

Noting that the proper test must come directly from the wording of 501(c)(3) and should further the long-standing intent of Congress, the court reasoned:

> "Assuming that large religious or educational publishers may qualify for an exemption, and assuming that not all such publishers are created as large entities, the question becomes one of defining the

> standards by which the growth in volume of a publisher will not in itself jeopardize the tax exemption."

Presbyterian, id. at 153.

Considering first the question of private inurement, the court observed that:

> "[t]he policy underpinnings of the non-inurement rule derive from the common law belief that charities should promote the public good rather than private benefit. In addition, to the extent that the personnel of a religious organization, particularly a select few, materially profit from the organization's activity, the sincerity of the claimed religious beliefs may be called into question."

The court found there was a complete absence of evidence to support a finding of private inurement. *Presbyterian, id.* at 153. The court found that P & R had established its need for accumulating cash in order to build new facilities. *Presbyterian, id.* at 157, n. 8. The Tax Court's *ad hoc* reliance on P & R's lack of denominational affiliation was summarily dismissed as irrelevant. *Presbyterian, id.* at 156.

At various places in the decision, the court distinguished some of the precedents most commonly relied upon by the Commissioner and the Tax Court, e.g., *Better Business Bureau v. United States*, 326 U.S. 279 (1945) and *Fides Publishers Ass'n. v. United States*, 263 F.Supp. 924 (N.D.Ind. 1967).

The court also observed that:

> "Although we recognize that the Tax Court is entitled to deference in determining the existence of a substantial, non-exempt purpose, that court must *focus on facts which indicate a purpose falling outside the ambit of Section 501(c)(3).* In this case, the Tax Court focused

primarily on two factors — the lack of affiliation with a par-ticular church and the *accumulation of profits*. As we have shown, neither factor indicates the presence of a non-exempt purpose here. Therefore, we must consider the balance of the record to determine whether all the evidence taken together supports a finding of non-exemption."[3]

Presbyterian and Reformed Publishing Co. v. Commissioner, 743 F.2d 148, 158 (3d Cir. 1984) (Emphasis added).

Distinguishing between purpose and activity, the Third Circuit Court concluded its "commercial activity" analysis by stating:

> "We do *not* read 501(c)(3) or its legislative history to define the *purpose* of an organization claiming tax-exempt status as a direct derivative of the *volume of business* of that organization. Rather, *the inquiry must remain that of determining the purpose to which the increased business activity is directed* ... Despite the long history of 501(c)(3) and the numerous organizations that have claimed its coverage, *no regulation or body of case law* has defined the concept of *'purpose'* under this provision of the Tax Code with sufficient clarity to protect against *arbitrary, ad hoc decision-making.*"

Presbyterian, id. at 156 (Emphasis added).

It is clear, therefore, that commercial activity in and of itself was not intended to and should not foreclose tax-exempt status. *See also, Northern California Central Serv. v. United States*, 591 F.2d 620 (Ct. Cl. 1979). It is equally clear that the use of any criteria other than the two statutory tests

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[3]The court also stated (citing *Bob Jones Univ. v. United States*, 461 U.S. 571 (1983) and *Bose Corp. v. Consumers Union*, 466 U.S. 485, 104 S.Ct. 1949 (1984)). "[t]he Tax Court's conclusion is not entitled to the deferential, clearly erroneous standard of review of Rule 52(a) of the Federal Rules of Civil Procedure ... Judged against the standard of review in *Bob Jones, Id.*, the Tax Court's determination of P & R' purpose under an incorrect legal standard is subject to plenary review by this Court." *Presbyterian and Reformed Publishing Co. v. Comm'r*, 743 F.2d 148, 158 n.9 (3d Cir. 1984).

leads to arbitrary and capricious denial of tax-exempt status.

The similarity of the facts in *Presbyterian, id.*, to those of the instant case are striking. UMA's stated purposes are comparable to P & R's. UMA operated essentially at a loss until 1969, when it had a gain from the sale of its airplane. Mr. Cole was forced to subsidize UMA's activities with his personal funds on numerous occasions (Tr., pp. 64, 102).

UMA was operated primarily by its founder, Mr. Cole, as a continuation of evangelistic activities he had conducted as an individual. UMA's operations were conducted initially out of Mr. Cole's garage and then out of a converted pole barn on Mr. Cole's property (Tr., p. 88). UMA relied extensively on volunteers, including Mr. and Mrs. Cole, as its managers and clerical staff.

Beginning in 1969, UMA experienced a considerable increase in economic activity and began reporting substantial profits, just as did P & R. By the beginning of 1975, UMA had accumulated net *non-cash* profits of $224,377, all of which was tied up in inventory of $312,473 (Admin. Rec., Exh. 31-AE, pp. 1, 2; Tr., p. 31). The assets in excess of UMA's accumulated net earnings were financed by debt.

The Commissioner revoked UMA's exempt status in 1980 (as he did with P & R) based upon an allegedly improper commercial *activity* (as he did with P & R), making the revocation retroactive, to apply from January

1, 1974 onward[5]. Thus on essentially the same basic factual pattern, *Presbyterian* permitted what the Eighth Circuit has now rejected.

Attempting to distinguish the instant case from *Presbyterian*, the court stated that UMA did not give the Commissioner notice of a need to accumulate profits as did P & R[6]. This empty distinction must fail since UMA did not accumulate cash as did P & R, UMA's net earnings were clearly invested in inventory necessary to its level of operations and that use was clearly reflected on its returns. Furthermore, notice to the Commissioner (or the lack thereof) of accumulated net earnings has nothing to do with the *bona fides* of the accumulation and is *not* a statutory requirement for exemption — only being "organized and operated" for an exempt purpose is required.

Second, the court stated that the merchandise sold by UMA was not "inherently religious" in nature. Apart from the initial dilemma of defining and applying such a concept, the fact remains that 501(c)(3) simply does not place such a limitation upon qualification for tax-exempt status. Moreover, many tax-exempt organizations deal in articles, such as food and clothing, that are not inherently religious, charitable or educational, yet the

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[5]As in *Presbyterian, id.*, the date retroactive revocation of exempt status was to commence coincided with the accrual of *profits, not* the purported change in *activity!*

[6]An accumulation of *cash* might be circumstantial evidence of private inurement, the presence of which is fatal to tax-exempt status under the second prong of the statutory test.

uses of those articles *are* in furtherance of an exempt purpose as in this case.

For example, the food and lodging sold to children at a church camp are not inherently religious, but they directly further the exempt religious and educational purpose of the camp. University bookstores sell pencils, paper, notebooks, texts and the like that are not inherently educational. It is only when the university shows the student what to do with the items that the educational purpose is fulfilled.

Just so in this case: UMA's pre-recorded tapes, the blank tapes and the equipment were not inherently religious, but when put to use under UMA's guidance, like the university's pencils, they fulfilled UMA's religious, educational and charitable purpose (Admin. Rec., Exh. 36-AJ and Exh. 38-AL).

UMA's use of some of the techniques used by secular businesses in buying inventory, banking, paying its bills and communicating with those it sought to serve, did not alter its exempt purpose. Virtually all tax-exempt organizations, such as churches, hospitals and universities, purchase from secular businesses, write checks, and print brochures "advertising" their programs and services. The proper test is an examination of the *purpose* for which the material goods and secular methods are utilized.

The fallacy of its reasoning is succinctly focused in the court's conclusion that UMA failed to meet its burden of "proving that [the Commissioner] erred in determining [UMA]'s *accumulated profits* were

being used to further a nonexempt purpose" (App. A, p. 18a, Emphasis added). This statement (a) presupposes the existence of a non-exempt purpose and (b) the accumulation of profits *for such purpose.* In point of fact, the Commissioner's revocation of UMA's tax-exempt status was not allegedly based in any way on the existence or use of UMA's "accumulated profits" — rather on UMA's activity! Furthermore, the court's statement reveals an absence of any examination of the *only* statutory requirements for tax-exempt status: UMA's subjective purpose combined with the absence of private inurement of net earnings. Clearly, the court's focus (as the Commissioner's) was on the mere *existence* of net earnings and nothing more![7] This approach is directly contrary to the logically consistent and Code-approved test followed in *Presbyterian.*

Unreconciled with *Presbyterian,* this case creates two different tests for determining the tax-exempt qualification for 501(c)(3) organizations who have accumulated earnings:

1. The Code-mandated test of purpose and inurement adopted by Presbyterian, and
2. The "prohibited profitable business activity" test of the present case.

At the very least, this Court should clarify this issue by reconciling these

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[7]Ironically, using the court's rationale that activity equals purpose, *no* organization engaged in so-called "ommercial activity" (as practically *all* tax-exempt organizations are to one degree or another) could *ever* be able to satisfy that tautological requirement.

divergent tests so that both he Commissioner and taxpayers can apply the now-confused law to future business activity and net earnings.

Furthermore, the Court should also explain how the Eighth Circuit's focus on UMA's retention of net earnings for its continued operations as some sort of forbidden *activity*, in and of itself, impermissibly adds *another* new requirement to 501(c)(3). *Presbyterian* holds that retention of profits was *envisioned and endorsed* by Congress, *not as a purpose* unto itself, but as an *activity in furtherance of an exempt purpose*. *Presbyterian, id.* at 153. This promotes financially sound public organizations to ensure their continued vitality in furtherance of the public good.

Moreover, UMA presented abundant uncontradicted documentary evidence and testimony regarding its purpose, meeting its *prima facie* burden of proof, and nothing refuting that evidence was presented to the court. In order to rule as it did, the court, in the absence of any evidence to the contrary, would have been required by basic rules of evidence to have totally discredited *every single item* of evidence and testimony offered to it by UMA. This it clearly did not do since it *adopted* much of UMA's evidence. Instead, what the court did was to improperly construe that evidence *against* UMA in direct opposition to the rules of evidence and this Court's standards.

The Eighth Circuit's adoption of the Tax Court's distinction of *Pulpit Resources v. Comm'r*, 70 T.C. 594 (1978) is similarly misguided in that it suggests that, had UMA been able to demonstrate *exactly* the percentage of

sales which were of pre-recorded religious tapes, its tax-exemption would have been salvaged. Again, this reasoning illustrates the fuzzy thinking that now abounds in this area of the law and totally ignores the interplay between *activity* and *purpose*. If the activity constitutes a forbidden purpose, what difference should it make what percentage it comprises of the total activity? Furthermore, a for-profit business could sell the same pre-recorded tapes as UMA for a non-exempt purpose (private inurement), while UMA could sell them for an exempt purpose. This rationale incorrectly focuses on the activity, not the purpose.

The Eighth Circuit's "profits equals purpose" doctrine eliminates any semblance of the "bright line" test set forth in 501(c)(3) and, if carried to its logical conclusion, exposes any otherwise exempt organization to retroactive loss of its tax-exempt status if it hire employees, prints catalogs, buys or sells on credit, enters into contracts, purchases or sells "secular" goods, occupies office space, maintains bank accounts or engages in any "commercial activity". The Commissioner must be foreclosed from using such a broad sword of his own design and manufacture to revoke at his whim the tax-exempt status of organizations that benefit the public by providing them with goods or services they otherwise could not obtain for uses they otherwise could not achieve.

II. THE EIGHTH CIRCUIT'S HOLDING THAT COMMERCIAL ACTIVITY, WITHOUT MORE, BY AN OTHERWISE TAX-EXEMPT RELIGIOUS, CHARITABLE OR EDUCATIONAL ORGANIZATION SOMEHOW CONSTITUTES AN IMPROPER "PURPOSE" IN AND OF ITSELF, VIOLATES FEDERAL LAW, AMOUNTS TO A JUDICIAL AMENDMENT OF 26 U.S.C. 501(c)(3) AND SHOULD BE ABROGATED BY THIS COURT.

When enacting 501(c)(3), Congress considered and adopted the common-law view that religious, educational and charitable organizations should promote public rather than private welfare. A proponent of the original version of 501(c)(3), Senator Bacon, explained that key factors in Congress' collective mind were: (1) the purpose of the organization; and (2) the absence of private benefit from the organization's net earnings. The presence of large net earnings and financial resources in tax-exempt organizations was explicitly *endorsed* as being in the public interest (44 Cong.Rec., pt. 4, at 4151 (1909)). Promoting such activities was a legitimate Congressional function for the benefit of the public and was well-founded in the common law. *Bob Jones Univ. v. United States*, 461 U.S. 571 (1983) at 588-92.

Congress explicitly contemplated the carrying-on of a trade or business by a 501(c)(3) organization without jeopardizing its tax-exempt status (*see* comments of Sen. Bacon, 44 Cong. Rec., *supra*). The very use of the phrase "net earnings" in the statute *presumes* some sort of profitable commercial activity.

Congress has even "blessed" commercial activity by a tax-exempt

organization where that activity is *not* directly related (in contrast to the instant case) to the organization's exempt purpose as long as the organization pays income tax on that ancillary income. *See*, 26 U.S.C. 511, *et seq*. The Commissioner has adopted the same position. *See*, 26 C.F.R. 1.501(c)(3)-1(e). This position necessary contemplates commercial, non-exempt activity by a tax-exempt organization of more than an insubstantial nature or else these statutes would be unnecessary.

The Commissioner's regulations state that the organization must serve a public rather than a private interest (26 C.F.R. 1.501(c)(3)-1(d)(1)(ii)). The regulations go on to provide that exemption will be granted under "any one or more" of the purposes "regardless of the purpose or purposes specified in [the organization's] application for exemption" (26 C.F.R. 1.501(c)(3)-1(d)(1)(iii)).[8]

"Religious" purpose is not defined *anywhere* in 501(c)(3) or the regulations thereunder. "Charitable" purpose is defined to include advancement of religion and promotion of social welfare (26 C.F.R. 1.501(c)(3)-1(d)(2)). "Educational" purpose is defined to include "instruction of the public on subjects useful to the individual and beneficial to the community" (26 C.F.R. 1.501(c)(3)-1(d)(3)(i)(b)) and may be accomplished via "a course of instruction by means of correspondence or through the utilization of television or radio" (26 C.F.R. 1.501(c)(3)-

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[8]This regulation effectively mutes any argument by the Commissioner that UMA's *change* in activities is fatal to its tax-exempt status where *all* of those activities furthered it evangelistic purposes.

1(d)(3)(ii), Example (3)).

This Court has also recognized the public policy rationale for Congress' exemption of certain organizations from income taxation. *See, Bob Jones Univ. v. United States*, 461 U.S. 571 (1983) at 588-92. In *Bob Jones Univ., id.* at 589, you stated that "Congress deemed the specified organizations entitled to tax benefits because they served desireable public purposes." You went on to quote with approval from *Trinidad v. Sagrada Orden*, 263 U.S. 578, 581 (1924):

> "Evidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain."

Bob Jones Univ., id. at 590.

You concluded by saying:

> "Charitable exemptions are justified on the basis that the exempt entity confers a public benefit — a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues."

Bob Jones Univ., id. at 591 (Emphasis added).

With regard to religious organizations *per se*, you have recognized that the public benefits conferred by religious organizations include a "beneficial and stabilizing influence in community life" and "the encouragement of diversified views and perspectives which contributes to a vigorous, pluralistic society." *Walz v. Tax Comm'n of the City of New York*,

397 U.S. 664, 673, 689 (1970) (Brennan, J., concurring).[9]

This Court has also stated that tax-exemption statutes are "liberalizations of the law in the taxpayer's favor, ... begotten by motives of public policy, and are not to be narrowly construed." *Helvering v. Bliss*, 293 U.S. 144, 151 (1934); *United States v. Pleasants*, 305 U.S. 357, 363 (1939).

The Eighth Circuit Court of Appeals, in adopting the decision and reasoning of the Tax Court, paid little more than lip service to the above standards enunciated by this Court. Its decision *ignores* the uncontroverted evidence UMA produced of extensive and consistent evangelistic purpose and how its activities directly furthered that purpose. The remainder of the evidence is construed *against* UMA, not liberally in its favor, as mandated by this Court. These are mistakes of law, not merely of fact.

By fostering the establishment and growth of Christian cassette tape libraries, UMA and its activities *personified* religious, charitable *and* education purposes under the common law and the Commissioner's own regulations! Religious purposes in that UMA sought the expansion and edification of the Christian body of believers; Charitable purposes for the same reason and also for the spread of socially-beneficial Christian ideals

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[9]For an excellent discussion of the public policy rationale underlying tax exemption as well as the misue of the "commercial manner" test by some lower courts in analyzing this difficult question, *see*, Brown, *Religious Nonprofits and the Commercial Manner Tes*, 99 Yale Law J. 1631 (1990).

of the "Good Samaritan" and brotherly love; Educational purposes in that the cassette tape libraries were instructive of the foregoing. The taped Christian messages were the key and the equipment to reproduce and listen to the tapes were a necessary corollary to the tapes.

By adopting the Commissioner's and the Tax Court's reasoning and legal standards, the Eighth Circuit Court has gone beyond the bounds of its judicial function and has, in effect, added a *third* requirement to 501(c)(3): "(3) none of whose activities may generate net earnings or be of a commercial nature." This addition to 501(c)(3) is not only an improper exercise of executive and judicial powers, it expressly conflicts with the clear language preceding it which actually *presumes* the existence of "net earnings" explained by Sen. Bacon upon the occasion of the statute's enactment (44 Cong.Rec., pt. 4, at 4151 (1909)).

In sum, what the Eighth Circuit did was focus its attention on the similarities in nature between UMA's *activities* and those of commercial businesses, while completely neglecting *any* examination of UMA's subjective purpose, whether and to what extent those purposes benefitted public as opposed to private interests, how UMA's activities actually furthered those purposes and whether UMA's net earnings inured to any individual or shareholder. In so doing, the Eighth Circuit elevated UMA's activities to the status of a purpose in their own right.

Such an exercise clearly results in a *non sequitur*. Certainly, an organization's activities may be evidence of its purpose, but to say its

activities are its purpose merely begs the question. Stated differently, an organization may utilize certain activities for the *taxable purpose* of producing a profit for the private inurement of some individual or, alternatively, for the *tax-exempt purpose* of benefitting the public at large. One may then properly look at the organization's activities to try to discern its purpose where the purpose is not obvious. But in either case, the activity is the means to an end (i.e., the "purpose"), not the end ("purpose") in and of itself.

One of this Court's earlier opinions heavily relied upon by the respondent, *Better Business Bureau v. United States*, 326 U.S. 279 (1945), in fact supports *UMA's* thesis. In that case, you looked at the organization's activities to discern its actual, as opposed to its stated, purpose. When you did, you found a type of private inurement — i.e., a purpose to benefit a limited class of for-profit businesses. At no time, however, did you reason that the organization's activity was its purpose or vice-versa. This Court correctly maintained the distinction between "means" and "end", "activity" and "purpose". Unfortunately, the Commissioner has taken your clear and simple analysis of activity versus purpose and has transmuted it into an illogical, non-contextual assertion that you intended activity to *equal* purpose and the Eighth Circuit upheld that flawed analysis.

In reality, what the Commissioner and the lower courts find objectionable is the existence of a non-taxed "profit" (Tr., pp. 103, 123). The record of this case clearly reveals that as long as UMA was small and

had no income, the Commissioner *approved* UMA's activities, including the distribution of cassette tapes. However, every time UMA had income, both in 1969 and then again in 1973, the Commissioner hastily conducted an audit. The Commissioner's elevation of an "activity" to the status of a "purpose" is nothing more than a bootstrap argument he has used with some success to gain access to accumulated earnings when it is more convenient for him to avoid a true examination of the difficult questions of purpose vis a vis public versus private inurement. How many more legitimate public-benefit organizations can this Court permit the Commissioner to destroy?

The Commissioner and the Eighth Circuit attempt to "end-run" this problem by arguing that UMA's activities changed from aviation to sales. Apart from the complete statutory irrelevance of that view, there are at least four fatal problems with their reasoning: First, the uncontradicted evidence was that UMA was conducting a substantial tape ministry *activity* in 1968 and 1969, the years previously audited, and that UMA discussed its developing activities with senior IRS personnel regularly. Second, it completely ignores the pertinent issue of UMA's *purpose* and whether either or both of those activities furthered that purpose. Third, the Commissioner's own regulations state that *any activity*, even a trade or business, that furthers the organization's exempt purpose will be acceptable. Fourth, the Commissioner's regulations state that *any exempt purpose*, even one not claimed by the taxpayer, will serve to ensure tax-

exempt status.

The Commissioner also objects to the fact that UMA's activities, to a great extent, consisted of the sale of blank cassette tapes and electronic equipment which were not *inherently* religious, charitable or educational. This approach, unfortunately, is irrelevant to the question of UMA's purpose. It is not important *what* was sold — what is important is *how* that activity related to UMA's purpose. These blank tapes and duplicating equipment *were* an inherent part of UMA's ministry, i.e., duplicating Christian messages for dissemination. If UMA's primary purpose really was commercial activity (a *non sequitur),* it could have generated much more profit by *selling only pre-recorded cassette tapes* under copyright or license agreements or by selling at near-market prices. Instead, UMA arranged its activities in such a way as to provide resources and tools for *others* — "*teaching* them to fish", if you will, not just "giving them a fish".

UMA dealt almost exclusively with Christians, using blatantly evangelical materials, and provided them with a means *they otherwise would not have had* to obtain high-quality pre-recorded tapes, blank tapes, reproduction and playback equipment at prices only a non-profit entity could provide (Tr., pp. 9-10). If the only issue had been whether these Christian organizations could have obtained satisfactory tapes and equipment and free technical expertise from commercial vendors at reasonable prices, UMA's services in that regard would have filled no public need in the charitable sense. UMA's experience and resources,

however, were directed toward implementing a new technology in support of Christian evangelism in a way that had never before been possible and *that's* what fueled the demand for its goods and services among Christian organizations and provided the animus for its activities. UMA's net earnings were *incidental* to its activity of serving the Christian mission field in this unique way and did not, logically could not, con- stitute an end in and of itself.

III. IF LEFT UNCHECKED BY THIS COURT, THE EIGHTH CIRCUIT'S HOLDING CALLS INTO QUESTION THE TAX-EXEMPT STATUS OF A LARGE PROPORTION OF THE RELIGIOUS, EDUCATIONAL AND CHARITABLE ORGANIZATIONS IN THE UNITED STATES AND WILL CHILL THEIR ACTIVITIES.

By erroneously commingling profitability and purpose, the Eighth Circuit has introduced a *rationale* into the tax law that is void of existing criteria for both quantifying and reviewing the application of its new law. Every 501(c)(3) organization that has net earnings or a quantum of "commercial activity" is thus subject to having its exempt status revoked on the non sequitorial ground of a changed *purpose*. Because the express language of the statute and the existing body of case law do not support its novel eiseiges of 501(c)(3), the Eighth Circuit has cast both the taxpayer and tax collector upon an uncharted sea whose shoals and shores are to be determined by ad hoc navigation, the direction of which is "whithersoever the governor (Commissioner) listeth."

If all net earnings are not "profits", then how are unacceptable net

earnings to be identified? Are only those profits earned by more-than-insubstantial "commercial activity" prohibited? If so, by what standards are the goods and services produced by exempt organizations to be distinguished from those produced by their nonexempt counterparts? It does not require the gift of prophecy to predict that the Eighth Circuit has launched federal taxation into a large and complex web whose parameters are left to judicial determination on a case-by-case basis, and that, without the benefit of demographic studies and committee hearings. Despite its admitted flaws, the *constitutional* method for tax legislation is an obviously more desireable alternative.

The Eighth Circuit court's mistake is *conceptual*. Though closely related, purpose and activities are not synonymous. Charitable *objectives* must of necessity be effectuated by *activities*, some of which are identical to those used by commercial enterprises. A loaf of bread produced by a soup kitchen for the homeless is mixed and baked by the same process used in a commercial bakery. It is the *purpose*, not the *activity*, that 501(c)(3) uses to exempt the soup kitchen from taxation, in a statutory context that admits the possibility of "net earnings".

Section 501(c)(3) cannot and does not prohibit commercial activity by exempt organizations. Neither does it prohibit profits. Instead, it codifies an ageless governmental policy of encouraging traditionally charitable activities by a simple twofold test of purpose and non-private inurement — taxing profits from the organization's *unrelated* business income, just as it

taxes other profits, but leaving the organization's tax-exempt status undisturbed.

The effect of the Eighth Circuit's decision, if left intact, will be to leave religious and charitable organizations and the Commissioner without any objective criteria by which to govern their actions. This cannot help but to chill religious and charitable endeavors in the United States and extending to the world, all in violation of the imminently practical intent of Congress and the underlying common law.

The Eighth Circuit has ignored UMA's exempt purpose and has held that UMA's profitable *activities* have somehow become its *purpose*. More than a neat semantic distinction, this erroneous process transmutes the purely factual question of subjective purpose into a mixed question of law and fact which empowers the Commissioner, at his fancy, to reclassify "activities" into an improper *"purpose"* under the Code. The Eighth Circuit Court has let the Commissioner, in effect, "bootstrap" his way around the clear and specific requirements of 501(c)(3) by giving an organization's *activities*, without more, the status of *purpose* in their own right.

The upshot of this result is that the tax-exempt status of any and all organizations is questionable if *any* commercial activity is found. There is no standard to guide the Commissioner or taxpayers in evaluating this question. After all, since the "commercial manner" test is one of executive and judicial, not legislative, creation what is to stop the Commissioner from expanding the application of that test arbitrarily and at will?

There is nothing to stop it, of course, and that is evident from the administrative record in *this* case which shows other organizations similar to or even more "commercial" than UMA have not had *their* exempt status revoked by the Commissioner (Admin. Rec., Exh. 40-AN). This leaves taxpayers and the courts on the proverbial "slippery slope".

The scope of this result, upon examination, could be staggering. It could apply, for example, to universities that sell tickets or broadcast rights to their sporting events,[10] sell food to sports patrons or students, sell books, supplies or housing to students; to hospitals that sell goods and services in competition with for-profit hospitals; to sales of donated goods by the Salvation Army in competition with second-hand for-profit clothing stores.

All religious, charitable and educational organizations have commercial characteristics to one extent or another. That is precisely why Congress enacted a "purpose" requirement instead of an "activity" requirement. Most, if not all, 501(c)(3) organizations have paid employees, purchase from commercial vendors, seek volume purchase discounts,

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[10]College athletics is a multi-million dollar *business* whose *profits*, like those of UMA, are often plowed back into stadiums and equipment intended to expand the enterprise. How are those activities distinguishable from UMA's? Certainly, § 501 (c)(3) does not draw that distinction. *U.S. News and World Report*, April 13, 1992 (p. 60) notes that of its $124 million in income, the N.C.A.A. earns $5.9 million from merchandise contracts and corporate sponsors and $2.8 million from sale of publications, videotapes and statistical services.

publicize the goods and services they make available to the public in an attempt to attract the public, maintain bank accounts and inventories. Tax-exempt charitable hospitals, for example, mark-up the selling price of medications and services above their cost as a means of covering the operating costs of the hospital's overall tax-exempt activities and to provide a financial reserve for future operations.[11]

Moreover, *practically none* of the goods and services distributed by these organizations are, in the final analysis, inherently religious, charitable or educational and, to that extent, these organizations "compete" with for-profit organizations. There is nothing inherently educational, for example, about a college sports event *per se* as opposed to a professional event; a college course on auto mechanics contrasted with one offered by a private vocational school; or used clothing purchased from a church thrift shop instead of from a secular second-hand clothing store.

The reason these organizations enjoy tax-exempt status is because of the *purposes* toward which these activities are directed — the college sporting event encourages the development of body as well as mind in the student; the auto mechanics course is educational and benefits the public as well as the individual; the church thrift shop provides work skills, funds

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[11] As long as this charitable hospital shows a "profit", it stays open to serve the public. "Net earnings" by a tax-exempt organization should be encouraged, *not* condemned as they are in this case, for even where the public enjoys the fruits of the organization's activities, how long could that organization exist if it spent more money than it took in?

and assistance — combined with the fact that none of the net earnings from these activities inure to the benefit of any shareholder or individual.

The potentially detrimental implications of this case to public institutions all across this country are too important and far-reaching to be left unresolved by this Court. The constitutional process for the result sought by the Commissioner and adopted by the Eighth Circuit Court is legislative — *not* executive or judicial. This case cries out for adherence to the reason and clarity in tax administration followed by *Presbyterian*, and the Court would well discharge its duties by settling this area of the law by either rejecting the Eighth Circuit's approach in favor of *Presbyterian* or reconciling the two approaches, providing detailed guidance to the Commissioner and tax-exempt organizations throughout the nation.

IV. THE COMMISSIONER ABUSED HIS DISCRETION UNDER CODE 7805(b) BY FAILING TO LIMIT THE RETROACTIVE EFFECT OF HIS REVOCATION OF EXEMPTION UNDER CODE 501(c)(3).

Even if UMA's exemption was properly revoked, the Commissioner erred in applying the revocation retroactively. 26 U.S.C. 7805(b) permits the Secretary of the Treasury to prescribe the extent to which rulings may be applied without retroactive effect. Regulations issued by the Secretary serve to limit the discretion of the Commissioner to decide the retroactive effect of an adverse decision. Such regulations must be strictly obeyed, *Lanson's, Inc. v. Commissioner*, 622 F.2d 774 (5th Cir. 1980), especially when a taxpayer has relied in good faith on an IRS determination of tax

status and retroactive revocation of that status would produce an inordinately adverse consequence to the taxpayer. Any failures of the Commissioner to abide strictly by his own limiting regulations constitutes abuse of discretion. Id.; see also *United States v. Church of Scientology of Boston, Inc.*, 739 F.Supp. 46 (D. Mass. 1990).

Generally, an adverse ruling may be given retroactive effect unless:

1. there has been no misstatement or omission of material facts;
2. the facts subsequently developed are not materially different from the facts on which the ruling was based;
3. there has been no change in the applicable law;
4. the ruling was originally issued with respect to a prospective or proposed transaction; and
5. the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retro-active revocation would be to his detriment.

26 C.F.R. 601.201(l)(5).

A separate regulation, 26 C.F.R. 601.201(n)(6)(i) provides that revocation of an exemption decision may be retroactive if the taxpayer has "omitted or misstated a material fact, operated in a manner materially different from that originally represented, or engaged in a prohibited transaction ...". At least one Court has regarded this passage of the regulation as imposing a burden on IRS to demonstrate at least one such reason before making a retroactive ruling. *United States v. Church of*

Scientology of Boston, 739 F.Supp. 46 (D. Mass. 1990).

In its decision to make revocation of UMA's exemption retroactive, IRS gave no reason in its initial decision of July 22, 1977 (Admin. Rec., Exh. 14-N, p. 5). Neither was a reason given in the first-level appeal decision of August 16, 1978 (Admin. Rec., Exh. 21-U, p. 7). Only upon rendering its final appeal decision at the National Level on July 16, 1979 (Admin. Rec., Exh. 27-AA, pp. 6-7) did IRS attempt to justify a ground for this inordinately harsh result. The reason ultimately chosen by IRS was that UMA had "materially changed [its] operation from those upon which [its] 1968 exemption ruling had been based." *Id.* at 7.

Given IRS's burden to justify a retroactive ruling, *Scientology*, 739 F.Supp. at 49, then its rationale for making this decision retroactive, articulated only at the final level of administrative appeal, is slender support for the harsh consequence that would result to this taxpayer.

Even if revocation were a proper result here, a decision to make that revocation relate back over two years before the taxpayer was first aware of the IRS's concern should rest on some more substantial basis than appears in this record. Especially so where the taxpayer relied upon repeated assurances by senior IRS personnel *and* the Commissioner's regulations state that *any* exempt purpose, even one not claimed in the initial

application, will be sufficient to support tax-exempt status.[12]

The conclusion of the Tax Court that UMA "operated in a manner different than originally presented" is simply unsupported by the record. As UMA has maintained throughout this case, the "activities" or "operations" that IRS insists were non-exempt were simply additional media to accomplish the primary religious purpose of spreading the Gospel through "any and all legitimate means" (Articles of Incorp., Admin. Rec., Exh. 1-A).

In its initial application for exemption, UMA stated its purpose as "conduct[ing] Christian activities in the interest of introducing Jesus Christ to as many individuals as may be possible ... ". Three examples of such activities were listed. The Articles of Incorporation, with a more extensive but open-ended selection of missionary activities, was part of the application.

In view of the tightly-focused religious purpose of UMA, along with the broad range of media available at the outset to further that purpose, it is not surprising that over the course of time UMA emphasized certain effective activities such as the tape ministry and diminished others, such as aviation, that became of lesser effectiveness in accomplishing UMA's

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[12]Mr. Jay Cole, UMA's President, discussed UMA's status under Code § 501(c)(3) with IRS personnel R.A. Turrentine, Roy Schelenberg, and Ellis Campbell, Jr. on at least three occasions during 1973, 1974 and 1975. All three IRS employees assured Mr. Cole that UMA was in compliance with § 501(c)(3) (Admin. Rec., Exh. 23-W, p. 15).

overriding goal.

One of the reasons for having regulations that limit instances of retroactive rulings is to avoid inequitable results. *Automobile Club of Michigan v. Comm'r*, 353 U.S. 180 (1957). See also, *Lanson's, Inc. v. Comm'r*, 622 F.2d 774 (5th Cir. 1980). If equitable considerations have anything to do with the decision to apply a ruling retroactively, then there must be some way of distinguishing the reasons for revoking the exemption from the reasons for applying the ruling retroactively. Here, the Commissioner relied on an alleged change in primary activity as its reason for revoking UMA's exemption. He then relied on the same alleged change in primary activity, with nothing more, as his reason for making the revocation apply retroactively.

The Commissioner's own regulations state that rulings will not be applied retroactively "except in rare or unusual circumstances" (26 C.F.R. 601.201(l)(5)). Cases applying these regulations require some additional showing by IRS, see *Scientology*, 739 F.Supp. at 49, before a ruling is to be made retroactive. Here, nothing additional was shown by IRS (beyond the disputed allegation of a change in principal activity) to justify retroactivity.

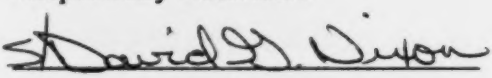
In view of UMA's good-faith reliance on the initial IRS exemption ruling, and the further assurances it received from IRS personnel, this Court should not permit the Commissioner to make its later ruling retroactive without some further showing on its part. Retroactive application of the ruling would impose a crushing burden on UMA, an inequitable and

disproportionate consequence that not only would terminate UMA's beneficial activities, but would tend to stifle other charitable and religious organizations.

CONCLUSION

For these various reasons, the Petition for Certiori should be granted.

Respectfully Submitted:



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APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT COURT

No. 91-1340

United Missionary Aviation, Inc.,	*	
Appellant,	*	Appeal from the United States Tax Court
V.	*	[UNPUBLISHED]
Commissioner of Internal Revenue,	*	
Appellee.	*	

Submitted: September 12, 1991

Filed: October 7, 1991

Before McMILLIAN, Circuit Judge, FLOYD R. GIBSON, Senior Circuit Judge, and WOLLMAN, Circuit Judge.

PER CURIAM.

United Missionary Aviation, Inc. (UMA) appeals from the tax court's affirmance of the revocation of UMA's tax exempt status. The Commissioner of Internal Revenue revoked UMA's tax exempt status after finding a substantial commercial purpose in UMA's activities. The revocation was made retroactive to tax year 1974, the year in which a significant increase in profits and income began. The tax court upheld the Commissioner's decision, and UMA has appealed.

After careful review of the record, we find no error in the tax court's decision. Accordingly, we affirm on the basis of the tax court's opinion. See 8th Cir. Rule 47B.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT

T.C. Memo. 1990-566

UNITED STATES TAX COURT

UNITED MISSIONARY AVIATION, INC., Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 21512-80X. Filed October 29, 1990.

R. Travis Douglas, for the petitioner.

Albert Sandlin and *Stacey Eisenberg*, for the respondent.

MEMORANDUM OPINION

KÖRNER, *Judge:* In 1980, after a lengthy audit and appeal process, respondent retroactively revoked petitioner's tax-exempt status for years beginning after December 31, 1973. Having exhausted its administrative remedies, petitioner came before this Court pursuant to Section 7428[1] seeking a declaratory judgment as to the correctness of respondent's action. We originally dismissed this case following petitioner's failure to file a brief as ordered by this Court at the conclusion of the trial herein. Following remand by the Court of Appeals for the Eighth Circuit, 890 F.2d 418 (8th Cir. 1989), reversing and remanding without published opinion an order of this Court, we must decide (1) whether respondent properly revoked petitioner's exempt status, and (2) if proper, whether respondent erred in giving this revocation retroactive effect.

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[1] All statutory references are to the Internal Revenue Code, as in effect for the year in issue, and all rule references are to the Tax Court Rules of Practice and Procedure, except as otherwise noted.

FINDINGS OF FACT[2]

United Missionary Aviation, Inc. (hereinafter petitioner or UMA), was incorporated in 1968 pursuant to the provisions of the Texas Non-Profit Corporation Act. That same year, respondent recognized petitioner as an organization described in 501(c)(3), exempt from Federal income taxes under 26 U.S.C. 501(a).

At the time of filing its petition herein, UMA had its principal place of business in Fayetteville, Arkansas. Petitioner's principal incorporator was Jay D. Cole (Cole). Throughout its history, Cole has held the position of president and director of UMA.

Cole is an ordained Southern Baptist minister who has worked in a variety of occupations. Cole received an aircraft pilot's license in approximately 1957 and in 1960 began a full-time aviation business. Beginning in 1965, Cole and his wife became acquainted with a missionary in the Bahama Islands. Cole began assisting this missionary by providing aviation services and other forms of assistance.

Cole sold his aviation business in 1967 and on January 23, 1968, petitioner was formed. UMA apparently was funded with Cole's equity in a

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[2]The record in this case consists of the administrative record, stipulated exhibits, and the record made at trial. Because this case involves the revocation of exempt status (where respondent undertakes his own fact finding), rather than the initial denial of tax-exempt status (where respondent accepts as true the statements of the organization, as contained in the administrative record), a trial concerning contested factual issues was warranted. See Rule 217(a) and the notes thereto.

single airplane. At that time, UMA's principal place of business was in Garland, Texas. UMA's articles of incorporation state that its corporate purpose is to:

> (a) Supply air transportation for missionaries and christian workers in furthering the spread of the Gospel of Jesus Christ.
>
> (b) Evangelize lost sinners using any and all legitimate means in order to make known the gospel and win souls to Christ.
>
> (c) Establish and edify local churches according to the New testament pattern.
>
> (d) [To] accomplish this two fold purpose, we will engage in all forms of missionary service including the sending, maintenance and support of missionaries at home and in foreign countries; sending gospel teams to conduct evangelistic, literature and visitation crusades; writing, printing and distribution of christian literature; Bible conferences, specialized forms of missionary work such as aviation evangelism, medical centers, photography, radio and television; the building of missions, chapels and churches; and other forms of missionary service as the Lord may lead.

Petitioner applied for exempt status in April 1968. In the application, petitioner gave a brief statement of the specific purposes for which it was formed:

> This organization [was] established to conduct Christian activities in the interest of introducing Jesus Christ to as many individuals as may be possible prior to His return to take His people out of this present world. This is to be done by assisting missionaries and Christian workers by providing air transportation where needed, speaking in churches and other organizations where opportunity is given to present the story of Christ, and to transport individuals to and from various mission fields where they may witness true Christianity in action.

The application also provided that UMA would not conduct any fund

raising drives or business engagements, and that its only activities would be those specified, as noted above. Additionally, the application stated that any "Funds received will be used to purchase needed items for various missionaries as need arise, and to pay expenses and maintenance on aircraft used in the mission enterprise." By letter dated September 30, 1968, respondent granted petitioner tax-exempt status based upon the information supplied by petitioner as to its purpose and operations.[3]

During 1968 and 1969, petitioner's primary activity was providing air transportation to various mission fields. UMA would organize groups of people to go to these fields to spend a week to ten days of interim training with a missionary. The air transportation supplied by UMA enabled these groups to fly directly to and from the mission fields where commercial transportation was often unavailable. To fund these trips, petitioner would charge the passengers for the cost of gasoline and oil. Petitioner, through Cole, stated that it tried to average at least one of these trips every two months.

For 1969, petitioner filed a Form 990-A, Return of Organization

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[3]An addendum to the letter granting exemption sent by respondent stated that since UMA's operations had been limited, the exemption was granted on the understanding that the continuing operations of UMA would continue to conform. The letter also stated that any changes in operation from those described, or in UMA's character or purposes, was to be reported immediately to respondent for consideration of their effect on petitioner's exempt status.

Exempt From Income Tax, and reported the following receipts and disbursements:

Gross Receipts (derived from aircraft sales and rental)	$16,780
Less: Cost of Goods Sold For All Business Activities (cost of aircraft)	(14,000)
Gross Profit	$ 2,780

Petitioner also reported expenses of earning gross income of $3,927.68, while receiving $1,409.81 in the form of contributions, gifts, grants, and similar amounts. In total, petitioner increased its net worth by $343.13 for the year. The gross receipts for 1969 reflect that at some point during the year petitioner sold its aircraft. Since selling its aircraft, petitioner to date has not provided any further air transportation.

On January 5, 1971, respondent reaffirmed petitioner's tax exempt status for taxable years 1968 and 1969. This action was based in part on information supplied by petitioner concerning its status. When asked to identify what type of organization it was, UMA provided respondent a copy of its articles of incorporation and a letter dated August 4, 1970, written by Cole as director of UMA. In it Cole stated that UMA was "presently involved in a teaching and lecturing effort in various schools and churches in an effort to interest Christian folks in entering the mission field, along with the activities listed in [petitioner's] articles of incorporation."

For taxable years 1970, 1971, and 1972, petitioner had gross receipts

under $5,000 and filed no returns.[4] For taxable years 1974 and 1975, however, UMA's receipts and disbursements increased substantially. The increase in petitioner's financial activity in 1974 and 1975 can be attributed to what petitioner designated as its Missionary Tape and Equipment Supply (MTES) division. Although MTES apparently was begun earlier,[5] respondent was first notified in writing of the existence of MTES when petitioner filed its 1974 Form 990.

In the early stages of MTES, petitioner assisted various churches and other religious organizations by providing them prerecorded religious cassette tapes and equipment to play them on. MTES itself produced the recorded tapes by obtaining a master tape from a religious speaker and then duplicating the tape for its own library. These tapes were then either sold or loaned to others so they could make their own copies. MTES also provided audio and visual equipment, and assisted in the selection and installation of this equipment.

During the early 1970's, there apparently was a dramatic increase in the use of cassette tapes to spread religious doctrine to shut-ins and other

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[4]The record is not clear whether a return was filed or what petitioner's gross receipts were for a tax year 1973.

[5]The parties disagree as to when petitioner began its MTES operation. Petitioner alleges it was performing the functions of MTES from the time it was organized and had orally notified respondent of this. Respondent contends MTES was not begun until after petitioner sold its aircraft. In any event, the parties agree that by 1974 MTES was in full operation

formerly inaccessible groups. Consequently, the demand for petitioner's goods and services increased resulting in a rapid expansion of its operations.

To facilitate its operations, petitioner spent $25,000 remodeling a barn on Cole's property. This barn housed petitioner's offices, tape library, and inventory. It also displayed merchandise that people visiting the facility could purchase. At its largest, in excess of $300,000 worth of tapes and equipment were stored on petitioner's premises.

Petitioner had both volunteer and paid employees. During 1973 and 1974, approximately 12 persons were paid employees in petitioner's MTES division. Cole, however, received no salary in any year.[6]

To promote its equipment, petitioner had catalogs published that were distributed to persons and organizations named on a mailing list provided by the publisher. Approximately 80,000 copies of "Catalog No. 3" were published and distributed in about 1974 at a cost of $24,225. In July and August of 1975, approximately 121,000 copies of "Catalog No. 4" were published and distributed.

Petitioner's catalogs were primarily secular, although they did contain some religious references. Catalog No. 3 was comprised of 89 pages. Quotes from the bible appeared in several places throughout the catalog.

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[6]Although the record is not clear on this point, it does appear that Cole was receiving approximately $600 per month from petitioner as rent for the use of his barn. In any event, Cole's only income during this period of time was approximately $900 per month obtained from his rental properties.

Pages 5 through 16 contained advertisements for religious tapes. The remainder of the catalog was devoted to commercial items including blank tapes, cassette players, amplifiers, calculators, home entertainment systems, am/fm clock radios, and citizen band radios. The manufacturers whose products are listed in the catalog include well known names such as Craig, Kodak, Sony, Sanyo, Hitachi, and Panasonic. The catalog also contained the statement: "If you have already received a copy of this catalog, please pass this copy on to someone else."

Catalog No. 4 contained all the information, other than price differences, previously described in Catalog No. 3. In addition, it also listed petitioner's own brand of cassette tapes as well as commercial catch phrases including the statement: "Missionary Tape & Equipment Supply is the largest distributor of bulk cassette tapes in the world." According to both catalogs, the prices listed were wholesale prices to Christian workers and above-wholesale prices to others. The tape prices were listed at $1.75 per tape plus 5 percent Texas sales tax. Those purchasing equipment were asked to include 10 percent of $6.00 for postage, whichever was less, the balance to be billed if greater.

Petitioner purchased its inventory directly from various suppliers. Petitioner had contact with a manufacturer's representative for its territory, who provided a printed price list. The merchandise was then financed by granting petitioner credit.

No sales invoices were kept by petitioner that would specify what

percentage of sales were attributable to recorded tapes versus what percentage of sales was attributable to blank tapes and equipment. Under petitioner's pricing structure, there was a 20-percent markup above wholesale which resulted in an average net profit of 7.9 to 8.2 percent, after all expenses were paid.

In 1974, UMA's Form 990 contained the following information:

Gross Sales and Receipts From All Sources	$ 1,054,492.73
Less: Cost of Goods Sold	(732,850.93)
Plus: Contributions, Gifts, Grants etc. Received	2,000.00
Gross Receipts	323,641.80
Less: Expenses Attributed To Gross Income	(150,203.71)
Increase in Net Worth	$ 173,438.09

Included in the expenses attributable to gross income was an expense of $50,721 for employee salaries and wages and $3,823 for contributions, gifts, grants, and similar amounts paid out.

In 1975, petitioner's Form 990 reported the following:

Gross Sales and Receipts From All Sources	$ 906,211
Less: Costs of Goods Sold	(707,076)
Plus: Contributions, gifts, Grants etc. Received	1,059
Gross Receipts	200,194
Less: Expenses Attributable to Gross Income	102,612
Increase in Net Worth	$ 97,582

Included in the expenses attributable to gross income was an expense of $46,773 for employee salaries and wages and $8,607 for contributions, gifts, grants, and similar amounts paid out. Not include in the contributions and like amounts paid out are approximately six instances that petitioner

can documents where it gave away free merchandise totaling something less that $10,000. Overall, from the beginning of 1974 to the end of 1975, petitioner's net worth increased from about $50,939 to $321,958.

In September of 1975, an agreement was executed whereby petitioner sold its MTES division to an unrelated organization for the wholesale book cost of the merchandise and the cost of the office equipment. That organization now runs the operation for a profit, although the sales agreement provided that the purchaser was to continue operating the tape and equipment supply as a nonprofit organization.[7] The sales agreement contained a covenant not to compete as to petitioner and Cole, individually, which precluded the latter parties from dealing in blank tapes and equipment supplies for a period of five years in the continental United States.

In a separate agreement, Cole, individually, sold his land, house, and barn for approximately $160,000 to the same organization that purchase MTES. No part of the purchase price was allocated to the barn nor did Cole turn over any of the money to petitioner despite the $25,000 improvements made by UMA to Cole's property. After selling his house, Cole moved to Fayetteville, Arkansas and petitioner moved with him.

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[7]The record does not explain whether petitioner attempted to enforce the agreement.

OPINION

Respondent determined that in operating a mail order sales business as its primary activity for years beginning after December 31, 1973, petitioner was not operated exclusively for exempt purposes as required by 26 U.S.C. 501(c)(3), so as to be exempt under 26 U.S.C. 501(a). Petitioner has the burden of proof in overcoming the grounds set forth in respondent's revocation letter. *Freedom Church of Revelation v. United States*, 588 F. Supp. 693, 696 (D.D.C. 1984); Rule 217(c)(2)(A).

26 U.S.C. 501(c)(3) provides, in part, that an organization which is organized and operated exclusively for exempt purposes, in which no part of the net earnings inure to the benefit of any private shareholder or individual, qualifies as a tax exempt organization. To be organized and operated for an exempt purpose, the organization must satisfy both the organizational and opera- tional test prescribed in 26 C.F.R. 1.501(c)(3)-1(b) and (c), Income Tax Regs. *Levy Family Tribe Foundation v. Commissioner*, 69 T.C. 615, 618 (1978). Respondent does not question petitioner's ability to pass the organizational test. Rather, respondent asserts petitioner failed to satisfy the operational test for years beginning after December 31, 1973.

26 C.F.R. 1.501(c)(3)-1(c)(1), Income Tax Regs., provides:

> (c) Operational test — (1) Primary activities. An organiza-tion will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in 26 U.S.C. 501(c)(3). An organization will not be so regarded if more than an insubstantial part

of its activities is not in furtherance of an exempt purpose.

In determining whether the operational test is met, our focus is on the purpose toward which an activity is directed, rather than the nature of the activity itself. *B.S.W. Group, Inc. v. Commissioner,* 70 T.C. 352, 356-357 (1978). Consequently, "Even if petitioner's activities would normally constitute a trade or business, petitioner will not be disqualified so long as its activities further an exempt purpose." *Janaluska Assembly Housing, Inc. v. Commissioner,* 86 T.C. 1114, 1121 (1986) (citing B.S.W. *Group, Inc. v. Commissioner, supra* at 357).

Although the exclusivity requirement of 26 U.S.C. 501(c)(3) does not mean "solely" or "absolutely without exception," *Church in Boston v. Commissioner,* 71 T.C. 102, 107 (1978), as explained by the Supreme Court in *Better Business Bureau v. United States,* 326 U.S. 279, 283 (1945):

> To fall within the claimed exemption, an organization must be devoted to [exempt] purposes exclusively. This plainly means that the presence of a single [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.* * *

Under this analysis, it is possible for an organization's activities to have multiple purposes, both exempt and nonexempt. *B.S.W. Group, Inc. v. Commissioner, supra* at 357. When an organization's activities have a nonexempt purpose, and that purpose is "substantial in nature," the operational test will not be met. *Manning Association v. Commissioner,* 93 T.C. 596, 604 (1989).

During the time in question, petitioner's primary activity was the

operation of its tape and equipment supply division. Determining whether petitioner's MTES activity encompasses a substantial nonexempt purpose, irrespective of the existence of any exempt purposes, therefore, is our critical inquiry. *Manning Association v. Commissioner, supra* at 611.

Making this determination is difficult at best. It is a question of fact to be determined by the facts and circumstances particular to each case. *Manning Association v. Commissioner, supra* at 603-604. To assist us in deciding this question, we note that the courts have generally focused on how an organization carries on its activities, implicitly reasoning that an end can be inferred from the chosen means. *Church of Scientology of California v. Commissioner,* 83 T.C. 381, 475 (1984), affd. 823 F.2d 1310 (9th Cir. 1987), cert. denied 486 U.S. 1015 (1988). Although no one factor alone is determinative, based on the facts before us, we hold that petitioner possessed a nonexempt commercial purpose that was substantial in nature. We find the following factors to be of particular relevance in this case:

1. The manner in which an organization conducts its activities is relevant evidence of a forbidden purpose. *B.S.W. Group, Inc. v. Commissioner, supra* at 359. Petitioner's tape and equipment supply division was operated in the same manner as that of any profitable commercial enterprise. Electronic equipment was purchased on credit from manufacturers, which was then used to stock petitioner's inventory. Petitioner thereafter sold this equipment by mail order, or, less frequently, directly to people visiting the display maintained on petitioner's premises.

Catalogs were used to promote the sales of petitioner's merchandise. Commercial catch phrases can be found throughout the catalogs, and proclaimed petitioner to be the largest distributor of bulk cassette tapes in the world.

2. Competition with commercial firms also is strong evidence of a substantial nonexempt purpose. *B.S.W. Group, Inc. v. Commissioner, supra* at 356-358. The majority of equipment and blank tapes offered by petitioner were also offered by other commercial firms. Even the prerecorded tapes offered by petitioner could be obtained from other distributors.

3. Whether an organization provides its materials at or below cost is another consideration in determining whether an organization has a commercial purpose. *Pulpit Resource v. Commissioner,* 70 T.C. 594, 610-611 (1978). Petitioner priced its merchandise approximately 20 percent above cost. This netted petitioner a 7.9-8.2 percent profit margin after expenses. Petitioner argues that its low prices enabled numerous religious organizations to purchase tapes and equipment they otherwise could not afford. The record contains several letters from some of these organizations supporting this contention. However, the selling of merchandise at a discount is not, of itself, a charitable deed.[8] *Federation Pharmacy Services, Inc. v. Commissioner,* 72 T.C. 687, 692 (1979), affd. 625 F.2d 804 (8th Cir.

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[8]Indeed, a less charitable interpretation might be that petitioner was willing to take lower prices in order to undercut its competition.

1980).

Petitioner also claims that its pricing formula was necessary because it gave away large amounts of tapes and equipment to various religious organizations. In these situations, petitioner claims it wrote up no-cost invoices so that the $3,823 for 1974 and the $8,607 for 1975 that petitioner's Form 990 shows as contributions, gifts, and like amounts does not reflect this free merchandise. Petitioner, however, can only document making approximately six donations for a total amount of less than $10,000, while it claims to have donated in excess of $200,000. It is axiomatic that persons claiming special tax treatment must maintain records to support their status. Sec. 6001; sec. 1.6001-1(c), Income Tax Regs. We refuse to acknowledge petitioner made contributions in excess of those which it can document.

4. Substantial profits, while not determinative, also indicate an organization's primary purpose is commercial in nature. *Scripture Press Foundation v. United States*, 152 Ct. Cl. 463, 470-471, 285 F.2d 800, 803-804 (1961), cert. denied 368 U.S. 985 (1962); *B.S.W. Group, Inc. v. Commissioner, supra* at 357. For 1974, petitioner had net profits of approximately $173,438. Even accepting dubitante petitioner's argument that its accountant inadvertently failed to report a $74,000 liability, petitioner had net profits greater than $99,000. In 1975, petitioner had net profits of $97,582. At the end of 1969, petitioner had a net worth of about $343. During the 1974 to 1975 period, petitioner's net worth increased

from $50,939 to $321,958.

Petitioner argues that it had an exempt purpose in accumulating its profits. In *& Reformed Publishing Co. v. Commissioner*, 743 F.2d 148 (3d Cir. 1984), revg. 79 T.C. 1070 (1982), the Court of Appeals for the Third Circuit overturned our holding that an accumulation of capital for business expansion by a publisher of religious materials was commercial in nature. The Third Circuit stated:

> In light of the clear notice to the IRS of [petitioner's] need to expand its physical capacity, the claim that the accumulated profits would be used for this purpose, and the recognition by the IRS of such expansion as a legitimate reason for cash accumulation, we are unable to affirm the Tax Court's determination that [petitioner's] cash-on-hand situation was a strong indication of a non-exempt purpose. [*& Reformed Publishing Co. v. Commissioner, supra* at 157-158.]

We find the reasoning in *& Reformed Publishing Co. v. Commissioner, supra*, to be inapplicable to the present case for three reasons. First, at no time did petitioner give respondent a notice of a need to accumulate profits. Second, the merchandise sold by petitioner was for the most part not inherently religious in nature. Third, and perhaps most important of all, petitioner has failed to meet its burden of proving that respondent erred in determining petitioner's accumulated profits were being used to further a nonexempt purpose. Petitioner, through Cole, testified that all of its proceeds were put right back into its tape and supply division and that "after everything was done" there was not any money left over until after MTES was sold in 1975. In a letter to respondent dated September 14, 1978, Cole stated that by July 1974 petitioner had incurred a debt of

$205,000 purchasing merchandise for various religious organizations which it decreased through the use of its profits to $50,000 by September 1975. As we noted above, we are not going to presume that petitioner donated for charitable purposes in excess of $200,000 worth of merchandise without any documentation to support it. We also note that petitioner's profits for 1974 and 1975 are determined after the cost of goods are taken into account.

Petitioner also makes an argument apparently based on the case of *Pulpit Resources v. Commissioner, supra*, where we held that an organization that prepared and published sermons for use by various clergy was operated exclusively for an exempt purpose. The facts at bar are also distinguishable from those in *Pulpit Resources*. By failing to keep records as to what portion of sales were from recorded religious tapes compared to all other sales, petitioner fails to prove to what extent, if any, it was selling religious literature. Despite the testimony by Cole that he knew most of the people purchasing from petitioner, we find that clergy were not the only purchasers. Petitioner did not prepare its mailing list and did not know all of its customers. It also encouraged people to pass the catalog on to others with no limitation as to who could purchase tapes and equipment. Based on the foregoing, we hold petitioner's activities with MTES show petitioner had a substantial commercial purpose.

Petitioner's alternative argument, that it should be taxed on its unrelated business income rather than have its exempt status revoked, must

also be denied. Requisite to having merely its unrelated business income taxed, petitioner must first prove that it is an exempt organization. 26 U.S.C. 511(a); *Orange County Agricultural Society v. Commissioner*, 893 F.2d 529, 533 (2d Cir. 1990), affg. a Memorandum Opinion of this Court. This it has failed to do.

By finding that petitioner was not operated exclusively for an exempt purpose, we need not address respondent's alternative argument that petitioner's net earnings improperly inured to the benefit of private shareholders or individuals.

The final issue for our consideration is whether the revocation should be imposed retroactively. 26 U.S.C. 7805(b) provides that the Secretary "may prescribe the extent, if any, to which any ruling or regulation, relating to the Internal Revenue laws, shall be applied without retroactive effect." Pursuant to this authority, the Secretary has limited respondent's discretion to retroactively revoke his rulings respecting organizations once found to be exempt by 26 C.F.R. 601.201(n)(6)(i), Statement of Procedural Rules, which states:

> *Revocation or modification of rulings of determination letters on exemption and foundation status.* (i) An exemption ruling or determination letter may be revoked or modified by a ruling or determination letter addressed to the organization, or by a revenue ruling or other statement published in the Internal Revenue Bulletin. *The revocation or modification may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented* * * *. In any event, revocation or modification will ordinarily take effect no later than the time at which the organization received written notice that its

> exemption ruling or determination letter might be revoked or modified. [26 C.F.R. sec. 601.201(n)(6)(i) (1990); emphasis added.]

A retroactive revocation will not be disturbed in the absence of an abuse of discretion. *Automobile club v. Commissioner*, 353 U.S. 180, 184 (1957). On the facts before us, we cannot say respondent abused his discretion.

We think petitioner operated in a manner materially different from that originally presented. On its application for exempt status, petitioner stated its purpose was to promote the Christian Gospel primarily by providing air transportation for missionaries and Christian workers. Respondent granted the exemption in 1968 based on this information and ont eh understanding that the continuing operation would conform. Petitioner disposed of its only airplane the next year. Although given numerous opportunities, petitioner did not inform respondent of its MTES division until filing its Form 990 for 1974. Petitioner contends that it was engaging in its MTES operations from its inception. Petitioner also argues that it orally let respondent's agent know of this fact and the agent told petitioner that the conduct of a mail-order activity would not jeopardize the exemption. Oral statements are not tax rulings and cannot be relied on as such. *Bornstein v. United States*, 170 Ct. Cl. 576, 582, 345 F.2d 558, 562 (1965). We conclude respondent did not err in revoking petitioner's tax-exempt status retroactively.

An appropriate decision will be entered.

Internal Revenue Service

Regional Commissioner Southwest Region

CERTIFIED MAIL

United Missionary Aviation, Inc.
Route 4, Box 384
Fayetteville, Arkansas 72701

Department of the Treasury

Address any reply to Appeals Office
Room 12325, 1100 Commerce St.
Dallas, Texas 75202
Person to Contact: Edwin H. Beus

Telephone Number: 214/767-1402
Refer Reply to AP:DAL:EHBeus

Date: Aug 28 1980
EIN: 75-6084184

Dear Sir or Madam:

This is a final adverse determination revoking your exempt status under Section 501(c)(3) of the Internal Revenue Code effective for years ending after December 31, 1973.

The adverse determination was made because in operating a mail order sales business as your primary activity you were not operated exclusively for exempt purposes as required by Code Section 501(c)(3).

Contributions to your organization after December 31, 1973, are not deductible under Section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120 with your Key District Director for exempt organization matters. You should inquire with the Dallas EP/EO Division about Forms 1120 for past years. The telephone number is (214)767-2728. Processing of income tax returns and assessing any taxes due will not be delayed because a petition for a declaratory judgment has been filed under Section 7428 of the Internal Revenue Code.

We will notify the appropriate State officials, as required by Section 6104(c) of the code, that based on the information we have available we are unable to recognize you as an organization described Section 501 (c)(3) of the Internal Revenue Code.

If you decide to contest this determination in court, a petition for a declaratory judgment proceeding in the United States Tax Court, the United States Court of Claims, or the United States District Court for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the Clerk of the appropriate court for rules for

filing petitions for declaratory judgment. For more information, please see the declaratory judgment section of the enclosed Publication 892.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Thank you for your cooperation.

Sincerely yours,

s/ Dwight M. Sumner

Dwight M. Sumner
Associate Chief, Appeals

Enclosure
Publication 892

26 C.F.R. 501(c)(3)-1

(c) Operational test — (1) Primary activities. An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages *primarily* in activities which *accomplish one or more* of such exempt purposes specified in Section 501(c)(3). An organization will not be so regarded if more than an *insubstantial* part of its activities is *not* in furtherance of an exempt purpose.

(2) Distribution of earnings. An organization is *not* operated exclusively for one or more exempt purposes of its net earnings inure in whole or in part to the benefit of private shareholders or individuals. For the definition of the words "private shareholder or individual", see paragraph (c) of 26 C.F.R. 1.501(a)-1.

* * *

(d) Exempt purposes — (1) In general. (i) An organization may be exempt as an organization described in Section 501(c)(3) if it is organized and operated *exclusively* for one or more of the following purposes:

(a) Religious
(b) Charitable
(c) Scientific
(d) Testing for public safety
(e) Literary
(f) Educational, or
(g) Prevention of cruelty to children or animals.

(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it *serves a public rather than a private interest.* Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

(iii) Since each of the purposes specified in subdivision (i) of this subparagraph is an exempt purpose in itself, an organization may be exempt if it is organized and operated exclusively for *any one or more* of such purposes. If, in fact, an organization is organized and operated exclusively for an exempt purpose or purposes, *exemption will be granted to such an organization regardless of the purpose or purposes specified in its application for exemption.* For example, if an organization claims

exemption on the ground that it is "educational", exemption will not be denied if, in fact, it is "charitable".

(2) Charitable defined. The term "charitable" is used in 26 U.S.C. 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in 26 U.S.C. 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such terms include: Relief of the poor and distressed or of the underprivileged; *advancement of religion;* advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and *promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.* The fact that an organization which is organized and operated for the relief of indigent persons may receive voluntary contributions from the person intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes. The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under 26 U.S.C. 501(c)(3) so long as it is not an "action" organization of any one of the types described in paragraph (c)(3) of this section.

(3) Educational defined. — (i) In general. The term "educational", as used in 26 U.S.C. 501(c)(3), relates to —

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or

(b) The *instruction of the public on subjects useful to the individual and beneficial to the community.*

An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion.

(ii) Examples of educational organizations. The following are

examples of organizations which, if they otherwise meet the requirements of this section, are educational:

* * *

Example (3). An organization which presents a *course of instruction by means of correspondence or through the utilization of television or radio.*

* * *

(e) Organizations carrying on trade or business — (1) In general. An organization may meet the requirements of Section 501(c)(3) although it operates a trade or business as a *substantial* part of its activities, if the operation of such trade or business is *in furtherance of* the organization's exempt purpose or purposes *and* if the organization is not organized or operated for the *primary* purpose of carrying on an unrelated trade or business, as defined in 26 U.S.C. 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the *size and extent* of the *trade* or business and the size and extent of the *activities* which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under 26 U.S.C. 501(c)(3) even though it has certain religious purposes, its property is held in common, and its profits do not inure to the benefit of individual members of the organization. See, however, 26 U.S.C. 501(d) and 26 C.F.R. 1.501(d)-1, relating to religious and apostolic organizations.

* * *

26 C.F.R. 601.201(l)(5)

(l) Effect of rulings.

(5) Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such ruling if (i) there has been no misstatement or omission of material facts, (ii) the facts subsequently developed are not materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable law, (iv) the ruling was originally issued with respect to a prospective or proposed transaction, and (v) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to his detriment.